Institutional Analysis of a Business Development Project

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After regaining its independence in the early nineties, Transyshnia began the transition from a command to a market economy and its integration into the world economic system. One of the government's main priorities became the promotion and development of the country's business environment. International organizations also assisted the government in supporting local entrepreneurs. They provided technical assistance through various training programs, and financial support through small- and large-scale credit schemes.

This paper evaluates the results of a recently completed business support project, undertaken by a general-purpose multilateral development organization (MDO) in association with the country's National Commission for Competitiveness and Entrepreneurship (NCCE). Unfortunately, the project did not meet its objectives, and this paper applies the AIC methodology to assess the extent to which poor institutional design was at the origin of the problems, and what alternatives could have been considered[2].

Background information

In 2000, the MDO and NCCE established a three-year project, "Support to Small and Medium Enterprises (SME) in Transyshnia." The main goal of the project was to promote and consolidate the country's SME sector by providing business and financial support services. The project was also supposed to provide the government with a package of recommendations on improvement of the overall business climate in the country. MDO allocated 500,000 US dollars for the implementation of the project, of which 50,000 US dollars were earmarked to administer a micro-lending scheme. The government also promised to allocate 100,000 US dollars from its budget for a complementary credit line. The implication, therefore, was that 150,000 US dollars of the overall project funds would support local entrepreneurs through the micro-lending scheme.

According to the project document, the project had four main components:

1. Establishing a Business Advisory Council to provide regular feedback and suggestions to the government and the donor community on the development of macroeconomic and sectoral policies and on ways to improve the financial, legal, and regulatory environment for business;
2. Providing financial support and technical advice on project proposal writing and fundraising to a local NGO, the Transyshnia Federation for Entreprises (TFE), and creating a strong business-training capacity within this organization;

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[2] See ODII, http://www.odii.com/ under sections "AIC: The Process" as well as under section "Papers" those by William Smith et al. The AIC methodology approaches institutional design from two perspectives: one is spatial and focuses on the institution's external environments; the other emphasizes the sequence of steps necessary to carry out the design process in relation with each of the institution's external environments.

3. Creating a Business Support Center (BSC) to provide local entrepreneurs with professional business consulting and financial services with micro-lending as a follow-up and;
4. Supporting women's entrepreneurial initiatives to achieve greater gender equality in the modern business community.

An international expert from one of the Eastern European countries was invited to run the project and was designated as Chief Technical Adviser (CTA) under the oversight of a representative from MDO and NCCE, respectively. While both representatives had almost identical responsibilities, the MDO representative was paid under the project, while the NCCE representative kept his much lower civil service salary. This was to cause many problems. Chart I shows the initial organization structure for the project.

The main staff of the project, namely three business and two financial consultants, were selected through a fully open and transparent recruitment process with advertisements in the local newspapers, structured interviews, and written professional tests. Once the selection was completed, the consultants received a five-week overseas training in consulting techniques. The training of the business and financial consultants was very practical and intensive and included internships in fully operational business support centers.

The implementation experience

Business Advisory Council

Problems started by the end of the project's first year. When the project-established Business Advisory Council held its first meeting, Minister-level government representatives had been expected to participate, but the government sent only mid-level executives. Upon learning this information the MDO's in-country representative and the chairman of NCCE decided not to attend the Council meeting either. From this very first meeting, the absence of the main decision-makers undermined the credibility and weight of the Business Advisory Council, its future proposals and recommendations, and the likelihood of their implementation. Therefore, all the subsequent meetings were held without any enthusiasm, just for appearance purposes.

Federation of Enterprises

Another problem occurred with the second component of the project. The Transyshnia Federation of Enterprises (TFE) was a co-implementer of the project. After a long negotiation process, MDO had chosen NCCE as its counterpart agency and included TFE as one of the beneficiaries of the project. However, NCCE viewed TFE as a rival in the provision of business support, and lobbied to reduce the amount of project support to TFE. As a result, TFE received only 2% of the project's funds. These monies came mostly in the form of renovation of the Federation's premises. Nevertheless, twelve members of the Federation were given a chance to benefit from a complex transfer of know-how in business training methods given by the consultants under the Business Support Center. Subsequently, TFE used their newly coached trainers to deliver business training and seminars to local entrepreneurs across the country.

Business Support Center

Advisory Services. In the implementation of the third project component, the setting up of a Business Support Center (BSC), only the first stage was successfully completed in the capital city of the country and initially offered free consulting services. Right from the beginning, the demand for such free business consulting/training services among entrepreneurs became obvious. More than 200 entrepreneurs benefited from one-to-one consulting services during the first six months of the center's activity. About 20 business training sessions were delivered by the consultants to already established entrepreneurs or those willing to start-up their own businesses during the same period of time. The high quality of the training and seminars attracted many other customers: private companies ordered training sessions and seminars for their employees, and international and local credit organizations ordered training sessions for their loan recipients. But project designers had assumed that after the services had been offered for free as a marketing strategy, and the value of the professional services had been recognized, enterprises would be prepared to pay normal consulting fees and thus allow BSC to become financially sustainable after project completion. This was not to be.

Micro-lending. After six months of activity, in accordance with the project document, BSC attempted to launch its lending activities to entrepreneurs. Unexpectedly, it was discovered that to get the right to lend, a special license was needed from the country's National Bank. To obtain this license, the project had to be a legal entity. Furthermore, the price of the license was approximately equal to the whole amount that the project had allocated for its micro-lending program. After long negotiations, the project sponsors decided that the project would contract out the lending program to one of the country's commercial banks. The aim of the lending program was to support entrepreneurs. The selected bank, however, had to agree to charge the loan recipients no more than 2.5% per year as an interest rate, irrespective of the rate of inflation -- which would not have covered the Bank's own costs. It took another six months to select the contracting bank, create a Credit Committee, and receive final approval from both sponsors of the project. When the lending procedure was almost ready to be launched, MDO requested that the government allocate the agreed upon complementary 100,000 US dollars to the project's account. Unexpectedly, the Ministry of Finance replied that since the project had not used this amount of money the previous year, it had not included these funds in the current year's budget. Indeed, no one had indicated that the project's funds should be carried over to the following year. Meanwhile, the Ministry of Finance had already re-allocated the 100,000 US dollars to other governmental needs. NCCE, as the representative of Government, assured MDO that the money would be allocated the subsequent year without any delay. Therefore, MDO and NCCE agreed to postpone implementation of the micro-lending program.

A few months later, NCCE and four other ministries and committees were merged into a single organization, the Ministry of Trade and Economic Development (MTED), and the Chairman of NCCE resigned. MTED replaced NCCE as the counterpart to MDO on this project. The new Minister was more dynamic than the chairman of NCCE and he started large-scale reforms in the field of economic development. He decided to revive the existing Fund for Entrepreneurship Development, which had been dormant under NCCE (leading government to mistakenly conclude that there was no demand for its loanable funds). The new Minister succeeded in persuading Government to increase these funds from $2 million to $10 million, and almost immediately, the Fund started lending to entrepreneurs again.

With this success, MTED concluded that there was no need for an additional micro-lending program and cancelled the project component. The MDO-financed project was advised that its role would now be limited to providing technical support to the potential recipients of the Fund. The Business Support Center continued its activity by providing one-to-one consulting services, elaborating business plans, and delivering training and seminars without charging for its services.

Women in Development

The fourth component of the project seemed to be the most successful. At the end of the first year of the project's activities, a Women in Development (WID) Business Support Center was established in one of the country's regions. Three local consultants were selected through a transparent recruitment process. They were coached by trainers at the Business Support Center in the capital city and sent abroad for internship. During their absence, the BSC consultants held several business sessions for women entrepreneurs in this region. After coming back, the newly-trained consultants started their activity by providing business consulting and training services not only at the administrative center of the region, but also in nearby and remote villages. These consulting services, again, were provided without charge.

After the cancellation of the micro-lending program, MDO decided to reallocate the original 50,000 US dollars to replicate the pilot WID Business Support Center in two other regions. A local consulting and training capacity was also created in these two regions, and MTED provided the centers with the necessary premises.

The centers worked very successfully. There was demand for their services and women entrepreneurs were even willing to pay for the services, except that the centers were not allowed to charge the clients until they would become legal entities. But a new problem occurred when MDO and MTED decided to register national and regional project centers as NGOs. All required documents for registration were collected and handed over to the Ministry of Justice at the end of the second year of the project's activities. But despite repeated official letters sent by MDO and MTED, the Ministry of Justice did not register the centers. As a result, the main objective of the project—to create sustainable business consulting organizations—was not achieved. The Business Support Center in the capital and the three regional WID Business Support Centers ended their activities after the project's completion.

Reinterpretation of the case in light of the AIC framework

While the goals and the objectives of the project seemed to meet the needs of the local business community, the project was unable to generate a demand for such services at a price that would have at least covered their cost; and in the case of the WID component, the inflexibility of project design did not allow even an attempt to do so. The technical and institutional design of the other components was so poor that they had no chance of success. A more thorough analysis of the project's enabling/ appreciated (A), influenceable (I) and controllable (C) environments might have led to a more positive outcome, as we will show below.

Appreciated environment

Successful project implementation requires, first of all, an enabling institutional environment favorable to the project goals and objectives. The initiator of the project must identify the key stakeholders and their resources, their ability to mobilize these resources, and attitude towards the project idea. These stakeholders should participate in the discussion of the project's purposes and trends in its enabling environment

In my opinion, the first mistake made by the initiator of the project, the MDO, was a lack of understanding of the appreciated institutional environment. Without prior consultations with other governmental and non-governmental organizations, MDO decided to choose NCCE as the counterpart implementing agency, and TFE as the main beneficiary of the project. This approach backfired almost from the very beginning. There were several reasons why:

- At that time, it was already known in the country that the IMF had required Government to merge NCCE with four other governmental institutions into one organization, because they were duplicating each other;
- Besides NCCE, there were at least five other governmental organizations suitable as a counterpart to this project;
- The designers were unaware or ignored the fact that the Entrepreneurship Fund under NCCE had never lent the funds it received annually from Government for preferential loans to local entrepreneurs;
- The designers did not consider the unfriendly relations between NCCE and TFE.

One may also wonder why the MDO attempted to act alone (i.e. without the advice of the IMF and World Bank, who specialize in the areas of macroeconomic policies and financial institutions) and ended up embarking on a project whose main components were either legally or financially unsound. Indeed, exclusive reliance on a weak organization with narrow vested interests, such as NCCE, was bound to lead to a misrepresentation and misappreciation of their capabilities. And while it is operationally easier and faster for MDO to negotiate and define common purposes with only one organization, consultation with all the project's main potential stakeholders and developing with them a consensus "vision" of a desirable future would have been preferable. As a result, as we saw earlier, the Ministry of Finance did not allocate the necessary funds to the project and the Ministry of Justice did not register the project's business centers as NGOs. Thus, the main objectives of the project were not achieved. Similar comments could of course be made about the design process for the Business Advisory Council.

Influenceable environment

After the project's launching, MDO and NCCE still had a chance to rectify the situation and to establish the necessary inter-agency linkages through negotiations with institutions whose support was needed to run the project successfully. Creation of the Business Advisory Council (BAC) could have been used to bring all stakeholders together and define common purposes. Using their considerable influence, the representatives of MDO and NCCE could have invited the top-level officials from the decision-making institutions. Instead, they decided that the externally recruited and hardly known project's Chief Technical Advisor (CTA) would be responsible for inviting the participants to the BAC meeting. As a result, no one from the governmental authorities took the creation of the BAC seriously and real decision-makers did not participate in its meetings.

More generally, the lack of coordination mechanisms with key external entities played a fateful role in the project's failure. The CTA tried to create some linkages with governmental and international organizations. But without real support from MDO and NCCE, nor from the World Bank and IMF, it was an impossible task. Moreover, direct links did not exist between the project initiators themselves. The MDO representative and the NCCE representative communicated with each other only through the CTA. Having different priorities, they sometimes gave controversial assignments to the CTA. On the other hand, taking into account that the CTA also had her own agenda and objectives, it is easy to understand that sometimes the information that came from one oversight agency to the other and vice-versa was not always correct. Also, in terms of incentives, it seems that there were few in favor of the project's success (which was a temporary activity), especially since the NCCE representative's future was with his own employer.

The weaknesses of the project's inter-organizational coordination contributed to the failure of the lending program. Ensuring that the Government would transfer the promised 100,000 US dollars to the project was the responsibility of NCCE, as a representative of the government. But for the Project Director, the new project presented essentially an additional burden without any financial compensation, as the project designers had failed to include the Project Director's salary into the project's budget. This was one of the reasons why the Project Director was not active in carrying out his responsibilities and led to the failure of two of the project's objectives: the establishment of a lending program, and the institutional sustainability of business development services. Indeed, (i) timely negotiations by the Project Director with the Ministry of Finance would have probably allowed the transfer of the funds for the lending program; and (ii) if he had actively lobbied with the Ministry of Justice, the issue of the business centers' registration as NGOs would have probably been solved. This is a classic example of how a lack of incentives can easily ruin the plans for a whole project.

Controllable environment

While neglecting the "appreciated" and "influence" aspects of institutional design, the project initiators paid considerable attention to its internal aspects which were under their "control". The management system of both sponsoring organizations, MDO and NCCE, was aimed at ensuring that their employees would produce successful reports. In particular, the Chief Technical Advisor, chosen by the project initiators, was really a professional report writer. She could reinterpret and portray all the project failures as tremendous successes. Being under pressure from both sides, she always succeeded in balancing both their viewpoints and satisfying their needs.

Actually, the measures taken at the "control" and implementation stage (transparent recruiting process, hiring highly professional staff, additional coaching of staff, etc.) prevented this project from completely collapsing. The project staff was managed by CTA, and consisted of an administrative assistant, and three business and two financial consultants. While the project initiators were struggling with the consequences of an inappropriate institutional environment, the staff hired under the project was professionally carrying out its responsibilities. The successful activities of the business centers, the real demand for their services and the thank-you letters from satisfied customers enabled the project initiators to forget about the failures of the other project components—the more so as the reports presented by CTA always praised the achievements of the project.

At the end of the project in 2003, MDO restricted its ex-post evaluation of the project to the activities of the capital city's Business Support Center and the WID Business Support Centers. MDO did not evaluate the unsuccessful, main components of the project. The evaluation findings satisfied all the organizations involved in the project's implementation. The project was proclaimed a success, but its sponsors decided not to continue it. And nobody bothered to find out whether the project had negative consequences on local business consulting and management firms who had to face the unfair competition of BSC's free services.

The idea of providing long-term technical and financial services to the local entrepreneurs was doomed to fail from the beginning. Replicating the same project design all over the world without adaptation to the domestic environment makes international aid organizations less efficient. The use of the AIC methodology proves one more time that a deep understanding of the external and internal environment of a country, the design of appropriate coordination mechanisms, and the use of appropriate incentive methods can prevent project failures. In my opinion, to ensure that such a methodology would be more systematically applied to project design and implementation, it would be better for international organizations such as MDO to become familiar with the AIC methodology, and verify that their internal incentives would reward its use. Otherwise, a too high level of bureaucracy, and reliance on feedback systems relying primarily on written reports will undermine effective use of the funds allocated to help developing countries.

Conclusions and recommendations

Applying the AIC methodology to the case described above, it is pretty obvious that the first (appreciated) and second (influence) stages of design were completely skipped. The main project initiators did not identify the main stakeholders, did not take into account the appreciated/enabling environment, did not reach common ground on the purposes of the project with the main stakeholders, and did not ensure that there would be a timely allocation of funds from the budget. In other words, the project initiators fully ignored the basics of the AIC methodology. This doomed the project.

Only the fact that the project initiators paid enough attention to the third (control) stage of design saved the project from full collapse, as long as it was supported by external financing. The personnel policy of the project was properly developed, the structure of the project was very effective, and it had both vertical and horizontal linkages, though with some important gaps (see Chart I). If the designers had applied the AIC methodology rather than start from a preconceived institutional model, they would have recognized that some of their objectives could have been achieved, and in a sustainable manner, e.g., if they had worked through the country's Federation of Enterprises. Indeed, that was the only sustainable component of the project, but ironically it was even missed by the narrowly focused ex-post evaluation of the project. Provision of services to businesses through the Federation of Enterprises would indeed have been viable because it would have been done as part of the activities of an existing self-financing organization. In other words, there was no need for an imported model of "Business Centers" which was only satisfying the needs of the donor agency for "their" visible project. And regarding the idea of a "Business Advisory Council", the irony of the matter is that some time after termination of the project, the right stakeholders revived the idea, and such a Council was created under the country's Presidency.

In conclusion, I would like to recommend that designers of development projects and their promoters apply the AIC methodology to assess how favorable the internal and external institutional environments are for successful implementation of the projects they finance. And, in case of doubt, they should assess what can be done to take advantage of existing positive elements, so as to improve such environments in favor of the projects. This common sense methodology should enable the designers to predict and overcome various institutional difficulties and obstacles, and thus minimize the risks of a wrong institutional design and its perpetuation during the project's life under external financing and thereafter.

Annex: 1

CHART I. THE INITIAL ORGANIZATION STRUCTURE OF THE BUSINESS DEVELOPMENT PROJECT